

Assessment Report

Level 3, 2008

Economics

- 90629 Understand marginal analysis and the behaviour of firms**
- 90630 Describe an economic problem, allocative efficiency, and market responses to change**
- 90631 Describe market failure and government interventions to correct for market failure**
- 90632 Describe aggregate economic activity**

COMMENTARY

Successful candidates attempted all sections of the papers. This was important, as questions asking for Merit- or Excellence-level responses generally also offered opportunities to demonstrate Achievement-level evidence.

Familiarity with the Explanatory Notes of the standards helped many candidates to gain higher grades.

The examination paper assessed the ability of candidates to apply economic concepts and models in a variety of situations. In order to succeed, candidates needed to accurately use appropriate economic terms when required, and explain the terms in relation to the context of the question – they needed to refer to the people, products, events and situations given. Graphs needed to be drawn accurately, labelled clearly, and any changes identified.

Merit-level candidates developed their ideas to a point where questions were completely answered. They identified the key economic idea and then explained how it addressed the question by developing the idea in at least two steps, for example what was affected, then why it was affected.

STANDARD REPORTS

90629 Understand marginal analysis and the behaviour of firms

Candidates who achieved this standard most commonly demonstrated the following skills and knowledge:

- ability to explain market structures and identify specific characteristics of monopolistic competition and perfect competition
- ability to calculate total utility, marginal utility, demand, average cost, total cost, fixed cost, and shutdown price
- ability to use costs to create a supply schedule
- limited ability to explain diminishing returns (more resources are required to increase output) but lacked the ability to explain that this increase relates to the additional unit
- ability to explain why a supplier will charge a higher price when marginal cost increases
- ability to graph individual perfect competitors and monopolists, clearly labelling price, quantity and subnormal profit
- ability to shift a marginal cost curve in response to a change in the market
- ability to explain why a perfect competitor will make only normal profit in the long run
- ability to explain marginal analysis and why a firm will always produce at the profit-maximising equilibrium of $\text{Marginal Cost} = \text{Marginal Revenue}$
- ability to apply definitions to the resource material.

Candidates who did NOT achieve this standard lacked some or all of the skills and knowledge required for Achievement. They also commonly:

- could not identify the characteristics of different market structures
- used incorrect terminology in written responses - e.g. referring to a “monopolistic competition” market structure as “monopolistic”
- described the barriers to entry in perfect competition as “weak barriers” rather than “no barriers”

- confused the Law of Equi-marginal Utility with the Optimum Purchase Rule
- could not derive Qd from marginal utility
- could not calculate fixed costs or derive Qs from marginal costs
- thought MR related to deduction of costs and that was why MR was always less than AR
- did not use a ruler to construct graphs, particularly when identifying Pe and/or Qe
- could not identify the profit maximising position, subnormal profit or long run equilibrium on a diagram
- drew a downward sloping $MR = AR = D$ curve for an individual perfect competitor
- recalled rote-learned definitions, but could not apply them to the resource material.

In addition to the skills and knowledge required for Achievement, candidates who achieved the standard with Merit commonly:

- drew diagrams precisely, using a ruler
- labelled all curves and equilibrium points accurately
- used MU to derive a demand schedule or used MC to derive a supply schedule
- knew that shutdown point was where $MC = AVC$
- explained that when a firm is experiencing diminishing returns, each additional unit of output required more variable inputs than the previous unit of output
- explained that firms would only supply a good if the price received matched MC
- understood the difference between MR and AR.

In addition to the skills and knowledge required for Achievement with Merit, candidates who achieved the standard with Excellence commonly:

- related their understanding of a firm that is experiencing diminishing returns, with each additional unit of output required more variable inputs than the previous unit of output, to Table 2 in Question 5 and increased MC, as per the instructions
- applied the law of demand and explained that a monopolistic firm needed to lower the price of all units in order to sell more.

Perspective

Successful candidates tended to use economic terms appropriately. In particular, they did not use the term monopolistic to refer to the market structure of monopolistic competition. As this standard focuses on marginal analysis, candidates needed to be aware that their answers should extend beyond $MC = MR$, i.e. the concepts of marginal profits and losses needed to be used to explain why situations change.

90630 Describe an economic problem, allocative efficiency, and market responses to change

Candidates who achieved this standard most commonly demonstrated the following skills and knowledge:

- ability to label a graph to show opportunity cost (as opposed to drawing unlabelled arrows) and recognise how a PPC illustrates scarcity
- ability to use a PPC to describe the concept of scarcity
- ability to identify shifts in supply and demand from resource materials, explain why they have occurred, and accurately show those shifts on a graph

- ability to identify consumer and producer surplus on a graph
- ability to describe how a market reacts to a situation of shortage
- ability to define deadweight loss
- ability to use the supply and demand model to correctly identify exports, production and consumption
- ability to recognise derived demand in a market situation and to explain how a change for a product will lead to a change in the demand for a related factor of production
- ability to describe effects on consumers of a removal of a tariff on our exports.

Candidates who did NOT achieve this standard lacked some or all of the skills and knowledge required for Achievement. They also commonly:

- confused how a PPC illustrates opportunity cost with how it shows scarcity
- repeated resource material rather than explaining why a change occurred
- wrote about a PPC showing how a “firm” has to choose, or how a PPC showed what resources were available, or how an economy can only produce butter or wool
- failed to label arrows
- used the terms Aggregate Supply/Demand when referring to a market for a single product
- “mixed their standards”, for example in Question 3(f) they talked about firms making sub/super-normal profits, and had no idea of the concept of the short and long run in a market
- saw a tariff on export goods as a source of income for the New Zealand Government
- failed to recognise that exported goods do not have a GST component in their price
- did not understand the concept of allocative efficiency and could not define deadweight loss
- could not identify changes to surpluses and deadweight loss.

In addition to the skills and knowledge required for Achievement, candidates who achieved the standard with Merit commonly:

- gave accurate reasons for shifts in supply and demand curves
- identified the consumer/producer surplus after a change in the market
- consistently used appropriate terminology to explain how a market reacts to change
- understood the concepts of short run and long run supply
- explained the concept of derived demand
- explained how a change in trade policy could affect government revenue.

In addition to the skills and knowledge required for Achievement with Merit, candidates who achieved the standard with Excellence commonly:

- provided full explanations of changes in the market and the role of market forces, which included all key points and used the correct economic terms
- linked changes in a market with changes in consumer/producer surplus
- clearly explained how the changes in the market would result in benefits to the Government or a loss of allocative efficiency
- fully understood of the concept of allocative efficiency.

Perspective

Generally, candidates seemed well prepared to tackle this examination paper and the style of questions asked.

It was of concern, however, that many candidates' answers to questions on the process by which a market clears did not reach the requirements of this level. The concept is not only fundamental to this standard but also to Economics as a subject. Successful candidates could accurately explain this process. Their answers went beyond the immediate effect on the market and explained why that effect would occur.

90631 Describe market failure and government interventions to correct for market failure

Candidates who achieved this standard most commonly demonstrated the following skills and knowledge:

- ability to label graphs correctly
- ability to give key definitions
- ability to read questions carefully and to give appropriate responses, not just rote-learned ones
- ability to show a negative externality and its impact on a graph
- ability to explain the impact of “internalising” an externality for producers (increased costs of production)
- ability to discuss why private firms do not provide public goods
- ability to discuss the concepts of equity and efficiency in relation to the unemployment benefit
- ability to draw graphs correctly using appropriate labels
- ability to answer short answer questions adequately by identifying and applying the key economic concept
- ability to make the basic point in Merit-level questions.

Candidates who did NOT achieve this standard lacked some or all of the skills and knowledge required for Achievement. They also commonly:

- repeated the question as their answer
- described when asked to explain
- could not graph, calculate or label a Lorenz curve or an MSC curve
- could not distinguish between public, private and merit goods
- could not define negative externalities or collective goods
- made no response to many questions
- answered with little detail and/or did not use economic terms.

In addition to the skills and knowledge required for Achievement, candidates who achieved the standard with Merit commonly:

- explained fully, recognising that a two-part response was often required
- understood key concepts of the standard and how they relate to private and social equilibrium
- identified or constructed appropriate Negative Externality and/or Lorenz curves on a graph
- discussed the impact of an increase in the unemployment benefit on efficiency or equity with appropriate and accurate references to the Lorenz curve, income distribution, equality, labour force, and productive efficiency
- appropriately and accurately explained the characteristics of public goods and private firms
- explained market failure using correct terms and the consequence of this market failure on a third party.

In addition to the skills and knowledge required for Achievement with Merit, candidates who achieved the standard with Excellence commonly:

- answered questions comprehensively and considered more than one possible answer
- discussed the impact of internalising an externality on businesses; in particular they identified the incentive to research other methods of production
- used resource material to draw inferences about how market failure would impact on equity or efficiency
- stated the logical consequences of the effect on efficiency for the decision making of the firm
- expanded the concept of equity to make full comparisons between winners and losers.

Perspective

Successful candidates appeared to be aware that the Assessment Specifications for this standard indicated that Merit/Excellence levels of performance would involve explaining/fully explaining how government interventions used to correct for market failure would impact on equity or efficiency. Discussions of those issues required a depth of explanation that went beyond the immediate effect. Flow on effects or explanations of why the effects occurred also needed to be developed.

60632 Describe aggregate economic activity

Candidates who achieved this standard most commonly demonstrated the following skills and knowledge:

- ability to show the effects of current economic events and fiscal policy on an AS/AD graph and appropriately label them
- ability to identify new equilibrium positions on AS/AD graphs
- ability to explain the causes of new equilibrium positions
- ability to calculate GDP or real GDP from the data supplied
- ability to partially answer questions about monetary and fiscal policy.

Candidates who did NOT achieve this standard lacked some or all of the skills and knowledge required for Achievement. They also commonly:

- failed to calculate GDP using the income approach or calculate real GDP from the data given
- could not identify from the national accounts the components of net exports
- could not identify the equilibrium on an AS/AD graph that would result from an economic event(s) - e.g. they correctly shifted AS left when nominal wages increased but incorrectly shifted AD right as well
- could not predict the effect of changes in AS/AD on inflation (did not match the change in inflation to the change in PL) or economic growth (did not match the change in economic growth to the change in Y)
- incorrectly labelled changes on AS/AD graphs (new curves were not labelled or the new equilibrium not identified with straight dotted lines or labelled $PL_1 + Y_1$)
- did not attempt every question in the paper, which meant the opportunity was missed to provide evidence for Achievement for partially correct answers in explain-level questions.

In addition to the skills and knowledge required for Achievement, candidates who achieved the standard with Merit commonly:

- explained how a loose monetary policy would prevent New Zealand from sliding into recession (Question link) by identifying that a reduced OCR (interest rate) would increase AD/real output and explaining how, for example, consumption spending would increase as the lower cost of borrowing increased credit spending
- explained why an expansionary fiscal policy shifts AD right (Question link) by identifying, for example, that income tax rates decrease and explaining that the consequent increase in household disposable income would result in increased consumption spending (which increases AD).

In addition to the skills and knowledge required for Achievement with Merit, candidates who achieved the standard with Excellence commonly:

- showed a depth of understanding of macro-economic policies either by:
 - explaining that a loose monetary policy would not be fully effective in offsetting a recession because, although the lower interest rate would cause AD to shift right thus increasing real GDP, they would also cause AS to shift left (as a weaker dollar would raise the cost of imported raw material) thus reducing real GDP, and as a result loose monetary policy would not be fully effective in offsetting a recession; or by
 - explaining that an expansionary policy does not conflict with the Public Finance Amendment Act, 2004, as this only requires the government to balance its (operating) budget on average (over the business cycle) once prudent debt levels have been achieved, so running budget deficits to offset a recession would not conflict with the Act, provided surpluses are run later to maintain balance (or to prevent debt levels rising above 20% of GDP).

Perspective

Most candidates seemed well prepared for this examination paper. The format of the paper and questions was similar to that of the papers of the last three years, and it was evident that many candidates were aware of comments in previous Assessment Reports as the quality of graph work was better than in earlier years and key macro concepts, such as monetary policy, were understood by nearly all candidates.

To demonstrate Merit-level evidence, a full answer is required. This means that candidates should identify the key point in their answer and then develop that with two further points, for example, a decrease in the OCR would cause an increase in AD/real output thus offsetting the recession (key point), as a fall in the return from savings (first point) would lead consumers to spend more (further point), which would increase AD.